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SUBJECT: BALOCHISTAN PROVINCE: FINANCIALLY DEPENDENT ON THE FEDERAL GOVERNMENT AND FACING INCREASED BUDGET SHORTFALLS

11. (U) Summary. As an underdeveloped region in Pakistan, Balochistan is dependent on the federal government for 94 percent of its budget and faces an estimated budget deficit of PKR 8.81 billion (USD 112 million) for the current 2008-09 financial year. Despite being the largest province in size geographically, Balochistan only receives 5 percent in federal tax revenue. It also receives revenue from the federal government in natural gas royalties, duties, and surcharges (which combined have declined 32 percent from FY2006-07 to FY2007-08) and a minimal amount from tax revenue despite being packed with natural resources and huge economic potential. As the Government of Pakistan (GOP) realizes that an International Monetary Fund (IMF) program may be inevitable for the economy to survive, development funds and provincial budgets will likely be cut to meet IMF conditionality. Since it is so reliant on the federal government for revenue, Balochistan could be extremely vulnerable when these cuts are made to meet the current balance of payment crisis. End Summary.

ECONOMIC WOES FOR THE PROVINCE

12. (U) Balochistan has experienced a series of financial crises throughout the last five years due to its heavy debt servicing liability. The province heavily depends on federal government financial support and does not receive any significant revenue yield from taxes. Balochistan relies on the federal government for approximately 94 percent of its budget. It has an estimated deficit budget of PKR 71.19 billion (USD 901 million at 79 PKR to USD) for the current 2008-09 financial year. The total income of the province for FY 2008-09 is estimated at PKR 62.38 billion (USD 790 million) against total expenditures of PKR 71.19 billion (USD 901 million). Sources of revenue include income from the province's natural resources which totaled PKR 9.746 billion (USD 123 million), income from provincial tax collection which was PKR 3.47 billion (USD 44 million) and income from federal grants and tax collection estimated at PKR 48.05 billion (USD 608 million).

13. (SBU) Income from natural resources is divided into three categories: royalties, surcharges, and excise duties. Royalties correspond to the payment by the federal government for the use of the natural gas. In FY 2007-08, royalties to Balochistan were PKR 2.68 billion (USD 34 million) up from PKR 2.24 billion (USD 28 million) in FY 2006-07. Surcharges represent the taxes on gas consumption paid by users of natural gas. In FY 2007-08, surcharges dropped to PKR 4.796 billion (USD 60 million) from PKR 10.99 billion (USD 139 million) in FY 2006-07 (a 56 percent drop). Excise duties

are taxes levied on the production of natural gas. In FY 2007-08, excise duties were PKR 2.27 billion (USD 29 million) up from PKR 1.13 billion (USD 14 million) in FY 2006-07. Year over year, income from natural gas dropped from PKR 14.357 billion (USD 182 million) in FY 2006-07 to PKR 9.746 billion (USD 123 million) in FY 2007-08. This drop is attributed to lower natural gas production, which was disrupted by law and order problems and supply transmission problems.

14. (SBU) When planning for the new fiscal year which began July 1, the Balochistan government sought financial help from the federal government during its budget announcement in June 2008, as it did not have financial resources for new development projects. On June 17, Prime Minister Yousuf Raza Gilani announced a PKR 6 billion (USD 76 million) grant for Balochistan from his special discretionary funds, as well as directing the Oil Gas Development Company to pay PKR 3 billion (USD 38 million) in outstanding debt to the Balochistan government. On October 20, the federal government announced that it would provide another PKR 3 billion (USD 38 million) in debt relief to the Balochistan provincial government from unidentified federal funds.

15. (SBU) In September 2008, the State Bank of Pakistan (SBP) also extended a financial package to mitigate the economic difficulties of the Balochistan Government. The package aims to provide breathing room by putting the provincial overdraft with the SBP into a blocked account which would be zeroed out within a period of six years through monthly deductions. In order to further aid the Balochistan government, the SBP will enhance the existing limit of the Ways and Means Advance to PKR 2 billion (USD 25 million) from PKR 1.7 billion (USD 22 million). (Comment: The Ways and Means

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Advance is a 4 percent interest loan advanced to a province by the State Bank of Pakistan. End Comment.) The SBP Governor Dr. Shamshad Akhtar, however, emphasized that the Balochistan government would truly reap the benefits of the financial package if it imposed strict financial discipline and more prudently managed its cash inflows from other resources such as natural gas royalties and surcharges. In response, the Balochistan government has imposed a complete ban on the purchase of new vehicles and on attendance of seminars in foreign countries. Other austerity measures enacted include a ban on convening official meetings at hotels.

16. (SBU) However, the additional money allocated to Balochistan from federal resources has already been consumed by additional expenditures on law and order, a reduction in oil and natural gas production, and higher pay and pension bills due to increased salaries from the recent increase in Pakistan's minimum wage from 4,600 rupees to 6,000 rupees per month. These problems continue to persist in the current fiscal year as nationalist militants, demanding autonomy and local control over the province's resources, have increased attacks on the gas pipelines. While the federal government has the mandate to distribute, transmit and supply the natural gas, the Balochistan government does not have enough representation in the National Assembly or within the federal government to induce more production, transmission and supply of natural gas within the province.

FEDERAL BUDGET SHORTFALLS IMPACT PROVINCES

17. (SBU) The federal government aims to gradually increase the allocated shares to provinces from federal tax revenues from 41 percent in FY2006-07 to 46 percent in 2010. The Punjab province gets 50 percent of federal government tax revenue while Balochistan receives only 5.22 percent. The Sindh province gets 34.85 percent and the North West Frontier Province (NWFP) receives 9.93 percent of federal tax revenues. The Pakistani "territories" of the Federally Administered Tribal Areas (FATA), Azad Jammu and Kashmir (AJK) and the Northern Areas are not allocated a share of the federal tax revenues since only provinces receive allocations. These "territories" however, are allocated income through the Public Sector Development Program (PSDP). Azad Jammu and Kashmir has been allocated PKR 11.99 billion (USD 152 million) under the PSDP for

FY2008-09 versus PKR 8.97 billion (USD 114 million) in FY2007-08, the Northern Areas have been allocated PKR 5.61 billion (USD 71 million) FY2008-09 compared to PKR 4.5 billion (USD 57 million) last year and FATA has been allocated PKR 8.6 billion (USD 109 million) for FY2008-09 compared to PKR 7.5 billion (USD 95 million) in FY2007-08.

¶8. (SBU) All of the provinces, except for Punjab, take issue over the resource distribution formula used by the federal government, which currently favors the provinces with larger population sizes. The provinces of Sindh, Balochistan, and NWFP claim that resource distribution should not be based on size of population solely, but rather on a combination of factors including the degree of poverty and tax contribution.

RICH IN RESOURCES BUT POOR AND UNDEVELOPED

¶9. (U) Balochistan is a resource and mineral rich province, though most of its natural resources are undeveloped. It is the largest province in terms of size of Pakistan with 44 percent (347,000 sq. kms) of the land area but is the smallest in terms of population, with only 5 percent of the population (8 million). The province, which in general lacks sufficient water resources to exploit its natural resource potential and to sustain its local economy, was hit recently by severe drought.

¶10. (U) Balochistan is endowed with a large number of natural resources, such as coal, gold, copper, silver, platinum, aluminum, chromite, zinc, and uranium, which are to a great extent unexplored and unutilized. The subsoil holds a substantial portion of Pakistan's energy and mineral resources, accounting for 36 percent of the country's total gas production. Balochistan has a 770 kilometer coastline, accounting for around 70 percent of Pakistan's

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total, which could prove to be an important trade corridor in the region by connecting China and the Central Asian republics to the Arabian Sea. The province is relatively deprived with inadequate health, education and employment facilities. It is predominantly rural with almost 50 percent of the total population living below the poverty line according to the Balochistan Poverty Reduction Strategy Paper of November 2003.

¶11. (SBU) Comment. Balochistan's financial future is closely tied with that of the federal government, leaving it extremely vulnerable in this period of economic crisis. As the GOP inches closer towards realization that an IMF program may be inevitable for the economy to survive, development funds and provincial budgets will be cut. The impact on the poor, particularly in the often overlooked Balochistan province, will be potentially harsh as food insecurity and funding shortfalls further reduce services which the provincial government will not be able to provide with the current resources. End Comment.

PATTERSON